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RSC Policy Brief:
Medicare Trustees' Report

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The RSC has prepared the following policy brief summarizing today's report issued by the Medicare trustees regarding the current and future solvency of the Medicare program.

Summary: The report issued by the Medicare trustees notes several funding challenges for the program in both the short and long term. The Hospital Insurance Trust Fund, which is funded primarily by payroll taxes and finances Medicare Part A, is "not adequately financed over the next ten years" according to the trustees' assumptions. The report projects that the Hospital Insurance Trust Fund will be exhausted by 2019—the same year of exhaustion as in last year's report, but at an earlier point within the year, due to lower payroll tax receipts and higher-than-expected expenditures.

While Medicare Parts B and D, financed by the Supplemental Medical Insurance Trust Fund, are considered adequately financed by the trustees, this determination stems largely from the fact that these portions of Medicare can—and do—claim a large and growing share of federal general revenues. The report notes that Part B costs have risen by an average 9.6% annually over the past five years, and is likely to grow by about 8% annually over the next decade, presuming Congress continues to override scheduled reductions in Medicare physician payment reimbursements.

In the longer term, the trustees project Medicare spending to rise sharply over the next 75 years. The report projects that by 2082, overall spending on Medicare will more than triple, from 3.2% of national gross domestic product (GDP) to 10.8%—nearly twice the projected size of Social Security, and more than one in every ten dollars spent in the private and public sectors.

Medicare "Trigger": For the third consecutive year, the trustees report includes a finding that general revenue Medicare spending—that is, Medicare spending not financed by payroll taxes, or by beneficiary premiums and co-payments—will exceed 45% of total Medicare outlays within the next seven fiscal years. This "trigger" language was included in Title VIII of the Medicare

Modernization Act of 2003 at the behest of the Republican Study Committee, to provide a mechanism for policy-makers to measure the fiscal soundness of the Medicare program, and for Congress to consider ways to reform its operations should entitlement spending continue to rise.

The trustees' warning means that, absent a change in current law, the next President will be required to submit legislation to Congress providing a remedy to bring general revenue Medicare spending within 45% of total Medicare outlays. In addition, the 111th Congress would be required to consider legislation addressing the funding warning by the summer of 2009, with special discharge opportunities available in both the House and Senate should leadership not bring legislation to the floor of each chamber. However, the "trigger" provision will not apply should Congress enact legislation remedying the trustees' latest funding warning this year.

Additional Background: Because of the uncertainties associated with budgetary projections spanning many decades, there are some suggestions that the significant unfunded liabilities included in the trustees' report may actually ***underestimate*** the losses Medicare faces. A November 2007 report by the Congressional Budget Office released 75-year projections materially divergent from the analysis released by the Medicare trustees. The trustees' report projects Medicare spending to consume nearly 11% of total GDP by the end of the 75-year period, while CBO estimates that Medicare will consume more than one in six dollars spent in the United States (17% of GDP). The disparity in the two projections stems from the trustees' assumption that excess cost growth—that is, the annual growth in health spending above the growth in GDP—would decline much more rapidly than both current and past levels of health care spending.[1]

Using data from the CBO report, as well as the trustees' 2007 update, former Medicare public trustee Tom Saving analyzed the size of Medicare's unfunded obligations. If the CBO projections are accurate, Medicare faces 75-year obligations of $38.4 trillion and infinite horizon obligations of $84.2 trillion, as opposed to $34 trillion and $74 trillion respectively under the assumptions in last year's official trustees' report.[2]

While the specific amounts of Medicare's future unfunded obligations by definition have yet to be determined, the trustees' long-range model may make it more likely that the trustees would underestimate rather than overestimate the size of the shortfall which Medicare faces. Fiscal prudence may therefore dictate that given that uncertainty, Congress should make every effort to restore Medicare's fiscal solvency now, so that future policy-makers will have a margin for error should further reforms be needed some decades from now. As the CBO report concludes, "the main message [from both reports] is that health care spending is projected to rise significantly and that changes in federal law will be necessary to avoid or mitigate a substantial increase in federal spending on Medicare."[3]

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[1] Congressional Budget Office, "The Long-Term Outlook for Health Care Spending," (Washington, DC, November 2007), available online at http://www.cbo.gov/ftpdocs/87xx/doc8758/11-13-LT-Health.pdf (accessed March 24, 2008), p. 16.

[2] Andrew Rettenmaier and Tom Saving, "Medicare's Future Burden: Trustees versus CBO Estimates," (College Station, TX, Private Enterprise Research Center, Texas A&M University, March 2008), available online at http://www.heritage.org/research/HealthCare/upload/Medicares_Future_Burden.pdf (accessed March 25, 2008), pp. 16-19.

[3] CBO, "Long-Term Outlook," p. 16.

Comparison with Prior Year Data: In addition to the updated projections regarding the date of the Medicare trust funds' exhaustion, the trustees' report also includes totals for Medicare's unfunded obligations for a 75-year budget window and an "infinite horizon" projection. Comparison charts for those projections follow:

Unfunded Obligation Projections for 75-Year Budget Window (2008-2082)

	2007 Trustees' Report (in trillions of dollars)	**2008 Trustees' Report (in trillions of dollars)**
Part A (Hospital Insurance)	$11.6 (1.6% of GDP)	$12.4 (1.6% of GDP)
Part B (Obligations less beneficiary premiums)	$13.9 (1.9% of GDP)	$15.7 (2.0% of GDP)
Part D (Obligations less beneficiary premiums and state "clawback" payments)	$8.4 (1.2% of GDP)	$7.9 (1.0% of GDP)
TOTAL	$33.9 (4.7% of GDP)	$36.0 (4.6% of GDP)

Unfunded Obligation Projections for Infinite Horizon

	2007 Trustees' Report (in trillions of dollars)	**2008 Trustees' Report (in trillions of dollars)**
Part A (Hospital Insurance)	$29.5 (2.6% of GDP)	$34.4 (2.6% of GDP)
Part B (Obligations less beneficiary premiums)	$27.7 (2.4% of GDP)	$34.0 (2.6% of GDP)
Part D (Obligations less beneficiary premiums and state "clawback" payments)	$17.1 (1.5% of GDP)	$17.2 (1.3% of GDP)
TOTAL	$74.3 (6.5% of GDP)	$85.6 (6.5% of GDP)

In general, the overall size of the unfunded obligations has remained nearly constant as a percentage of GDP, while growing in absolute dollar terms. Of particular note is the fact that while Part A obligations remained constant in GDP terms, and Part B obligations rose as a percentage of GDP, the obligations associated with the privately-administered Part D prescription drug benefit remained constant in dollar terms and decreased as a percentage of GDP. Although introduction of a prescription drug benefit has significantly increased Medicare's unfunded obligations in absolute terms, the fact that competition among Part D participants has slowed the growth of its costs suggests that similar efforts to inject competition into Medicare Parts A and B could comprise one element of comprehensive Medicare reform.

Revenue-Based "Reform" and Its Impact: Several studies have examined ways in which the Medicare program could be made fiscally solvent by increasing revenues, and these options appear neither economically viable nor politically palatable. In 2005, the Heritage Foundation published a report using that year's trustee data to determine the level of payroll taxes needed to close Medicare's funding gap. The report noted that, in order to achieve a 75-year balance, Medicare payroll taxes would need nearly to quintuple—from the current 2.9% up to 13.4%, where they would remain until 2079. The study also found that this tax increase would sharply affect economic growth, lowering real GDP levels by nearly $200 billion annually (resulting in lower corporate and income tax receipts), and reducing private sector employment levels by more than 2.2 million jobs over the course of a decade.[4] In other words, by decreasing personal income levels, a significant tax increase to ensure Medicare's solvency would reduce personal consumption at rates that could have a long-term stagnating effect on the American economy.

Former Medicare public trustee Tom Saving has also published some unofficial projections about the level of beneficiary contributions required for Medicare to achieve fiscal balance, presuming that the share of general revenues used to finance the Medicare program remains constant. In the case of such a scenario whereby only seniors pay for the increase in Medicare spending, premiums would rise exponentially, such that by 2081, retirees would be paying premiums in a range of $3,000 to $4,900 per month ***in year 2006 dollars***.[5] Although some additional cost-sharing for beneficiaries may be necessary in the context of overall Medicare reform, the idea that seniors could pay the future equivalent of $30,000-$50,000 annually in premiums alone is unrealistic.

Reform Options: In light of the difficulties discussed above with revenue-based options to solve Medicare's fiscal woes, a more feasible alternative might couple targeted opportunities for increased beneficiary cost-sharing with reforms designed to empower beneficiaries with the information and incentives needed to direct and control their health spending. Comprehensive proposals to reform Medicare in this vein could include:

Premium Support: This model would convert Medicare into a system similar to the Federal Employees Benefit Health Plan (FEHBP), in which beneficiaries would receive a defined contribution from Medicare to purchase a health plan of their choosing. Previously incorporated into alternative RSC budget proposals, a premium support plan would provide a level playing field between traditional Medicare and private insurance plans, providing comprehensive reform, while confining the growth of Medicare spending to the annual statutory raise in the defined contribution limit, thus ensuring long-term fiscal stability.

Consumer-Driven Health Options: These reforms would build on the success of the Health Savings Account (HSA) model in reducing health care cost growth for the under-65 population. Reforms in this area would alter the existing prohibition forbidding holders of HSAs from contributing additional funds to their accounts once they become Medicare-eligible. A new payment mechanism could allow these beneficiaries to keep their HSA-compatible insurance policy into retirement, with Medicare financing a portion of the premium. In addition, reforms to Medicare Medical Savings Accounts (MSAs) could make them more attractive to beneficiaries who do not have an existing HSA, providing additional incentives for seniors to become more cost-conscious when considering health care treatment options.

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[4] Tracy Foertsch and Joe Antos, "The Economic and Fiscal Effects of Financing Medicare's Unfunded Liabilities," (Washington, DC, Heritage Foundation Center for Data Analysis Paper CDA05-06, October 11, 2005), available online at http://www.heritage.org/Research/HealthCare/upload/83702_1.pdf (accessed March 24, 2008), pp. 7-9.
[5] Rettenmaier and Saving, "Medicare's Future Burden," p. 8.

Restructure Cost-Sharing Requirements: This concept would restructure the existing system of deductibles, co-payments, and shared costs, which can vary based on the service provided. Additionally, Medicare currently lacks a catastrophic cap on beneficiary cost-sharing, leading some seniors to purchase Medigap policies that insulate beneficiaries from out-of-pocket costs and provide little incentive to contain health spending. Reforms in this area would rationalize the current system, generating budgetary savings and reducing the growth of health spending.

Means Testing: This idea would establish an income-related Part D premium consistent with the Part B "means testing" included in Title VIII of the Medicare Modernization Act. The proposal—which was included in the President's Fiscal Year 2009 budget proposal—would achieve savings of $3.2 billion over five years. The RSC has previously included similar proposals in its budget documents as one way to constrain costs and ensure consistency between a Part B benefit that is currently means-tested and a Part D benefit that is not.

Increase Medicare Part B Premium: The RSC has previously proposed increasing the Part B premium from 25% to 50% of total Medicare Part B costs, consistent with the original goal of the program. This concept would not impact low-income seniors, as Medicaid pays Medicare premiums for individuals with incomes under 120% of the federal poverty level.

Conclusion: The Medicare funding warning issued by the trustees last year, and again this year, provides an opportunity to re-assess the program's structure and finance. These two consecutive warnings—coupled with the trustees' estimate that the Medicare trust fund will be exhausted in just over a decade's time—should prompt Congress to consider ways to reduce the growth of overall Medicare costs, particularly those which utilize competition and consumer empowerment to create a more efficient and cost-effective Medicare program.

The Administration has put forward two separate proposals—the first in its Fiscal Year 2009 budget submission to Congress, the second as part of its formal submission of legislation (H.R. 5480) required under the MMA "trigger"—to address Medicare's long-term solvency issues and begin a process of comprehensive reform. Many conservatives are likely to view the trustees' warning as providing another impetus for action on proposals that curb soaring entitlement spending, using the measures described above to advance the discussion beyond annual funding warnings and toward actions that ensure Medicare's long-term fiscal stability.

For further information on this issue see:

- *Medicare Trustee Reports*
- *Medicare's Future Burden: Trustees versus CBO Estimates*
- *RSC Policy Brief: President's Medicare "Trigger" Proposals*
- *RSC Policy Brief: Medicare Funding Warning*
- *Heritage Foundation Report: The Economic and Fiscal Effects of Financing Medicare's Unfunded Liabilities*

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